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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY,
INC., AN ARIZONA CORPORATION, FOR A
DETERMINATION OF THE CURRENT FAIR
VALUE OF ITS UTILITY PLANT AND
PROPERTY AND FOR INCREASES IN ITS
RATES AND CHARGES BASED THEREON
FOR UTILITY SERVICE BY ITS PARADISE
VALLEY WATER DISTRICT.

Docket No. W-01303A-05-0405

Arizona Corporation Commission

DOCKETED

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IN THE MATTER OF THE APPLICATION OF
ARIZONA-AMERICAN WATER COMPANY
FOR APPROVAL OF AN AGREEMENT
WITH THE PARADISE VALLEY COUNTRY
CLUB.

Docket No. W-01303A-05-0910


NOTICE OF FILING RUCO'S REPORT ON
STEP ONE ARSENIC FILING - PARADISE VALLEY DISTRICT

On December 19, 2006, Arizona American Water Company filed its Step-One ACRM filing for its Paradise Valley Water District, seeking a surcharge of \$15.67 to the monthly minimum charge, and \$0.4788 per 1,000 gallons to the commodity rate.

The Residential Utility Consumer Office ("RUCO") hereby files its Report on its audit of the ACRM filing. RUCO recommends a surcharge of \$14.48 to the monthly minimum

1 charge and \$0.4425 per 1,000 gallons to the commodity rate, as presented in the
2 Company's Revised Step-One ACRM Schedules filed on February 14, 2007

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4 RESPECTFULLY SUBMITTED this 16th day of February 2007.

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6 
7 Daniel W. Pozefsky
8 Attorney

9 AN ORIGINAL AND FIFTEEN
10 COPIES of the foregoing filed this
11 16th day of February 2007 with:

12 Docket Control
13 Arizona Corporation Commission
14 1200 West Washington Street
15 Phoenix, Arizona 85007

16 COPY of the foregoing hand delivered/
17 mailed this 16th day of February 2007 to:

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6 By

Ernestine Gamble

Ernestine Gamble

TO: Stephen Ahearn, Director
Scott Wakefield, Chief Counsel
Marylee Diaz Cortez, Chief of Accounting and Rates

FROM: William A. Rigsby

DATE: February 15, 2007

RE: Report on RUCO's audit of Arizona-American Water Company's
December 19, 2006 filing for an Arsenic Cost Recovery Mechanism
("ACRM") Step 1 rate increase for its Paradise Valley District.

AUDIT OBJECTIVE: The purpose and objective of this audit was to verify the capital expenditures of Arizona-American Water Company's ("Arizona-American" or "Company") recently completed Paradise Valley District arsenic removal facility, to verify that the facility is actually in service, to verify compliance with Decision Nos. 68310 and 66400 (which authorized the ACRM), and to verify the accuracy of the Company-requested ACRM surcharge.

AUDIT PROCEDURES: The following audit procedures were performed:

- 1) Verified that all schedules that are required by Decision No. 66400 are included in the application.
- 2) Reviewed Earnings Test for compliance, accuracy, and determined if the Company had passed the Earnings Test.
- 3) Reviewed all arsenic plant invoices, looking for such things as misallocations, unreasonable costs, non-arsenic plant costs, double billings etc.
- 4) Verified accuracy of Task Order totals and grand total.
- 5) Reviewed Revenue Requirement calculations for accuracy and compliance.
- 6) Reviewed rate design for compliance with 50/50 requirement, accuracy of calculations, and checked the reasonableness of the billing determinants by comparing to the prior rate case.
- 7) Traveled to the arsenic removal facility site and verified that the Paradise Valley facility was actually in service.
- 8) Met on two separate occasions with representatives of Arizona-American and Arizona Corporation Commission ("ACC") Staff to insure that arsenic treatment plant assets were properly allocated (the

facility also serves as a business office, a booster station and a storage facility for recently approved fire prevention upgrades.

AUDIT FINDINGS:

The Company voluntarily adjusted the AFUDC accrual rate authorized in Decision No. 67093, which was an issue in the Company's first two ACRM filings.

The Company also voluntarily removed overhead costs that cannot be directly charged to a specific task order and were allocated to all construction projects. Those costs were an issue in Arizona-American's first two ACRM filings also, because the ACRM process was extraordinary and as a result intentionally limited to those costs that were specifically identifiable to the arsenic plant.

This filing differed from prior Arizona-American ACRM filings because the arsenic removal plant was built within an existing facility that had been previously used as a booster station and storage facility. In addition to replacing the existing booster pumps and storage tanks, the Company also built a new business office and increased the amount of water storage for both arsenic treatment and fire prevention.

Prior to and after meeting with representatives from the Company and ACC Staff, the Paradise Valley District's ACRM was accurate and in compliance with Decision Nos. 68310 and 66400 with the following exceptions:

- 1) Task Order No. 50073241 (Structures and Improvements), included a number of site improvement costs that had not been properly allocated to the existing facility's other functions (i.e. business office, fire flow etc.) besides arsenic treatment.
- 2) Two invoices totaling \$474,000, related to Task Order No. 50073250 (Water Treatment Equipment), were missing from the supporting documents that were provided to ACC Staff and RUCO by the Company.
- 3) A series of accounting entries for an invoice in the amount of \$32,000, related to Task Order No. 50073244 (Pumping Equipment), had to be researched in order to determine if those costs were assigned to the proper Task Order.

- 4) Several booster pumps associated with the arsenic treatment facility had not been properly retired from the Company's plant in service account. RUCO also requested that the Company confirm that three 400 hp pumps, associated with the Company's Miller Road Treatment Facility, were contributed and would have no impact on the required adjustment for retired plant.
- 5) Task Order No. 50073242 (Power Generation Equipment), included the costs of a diesel powered standby electrical generator that had not been properly allocated to the existing facility's other functions (i.e. business office) besides arsenic treatment.

On Wednesday, February 7, 2007 representatives of Arizona-American and ACC Staff met at RUCO's request to address RUCO's concerns about the discrepancies listed above and to also discuss concerns raised by ACC Staff.

Directly after this initial meeting, held at the Commission's offices, members of the Company's regulatory affairs and engineering staff sat down with RUCO's lead analyst in RUCO's conference room to resolve the majority of RUCO's audit findings.

A follow-up meeting with representatives from Arizona-American and ACC Staff was conducted at RUCO's offices on Thursday, February 8, 2007. During this meeting, the majority of ACC Staff's concerns were resolved and RUCO's remaining plant allocation adjustments were finalized with the help of the Company's regulatory affairs and engineering staff members. As a result of these meetings, both ACC Staff and RUCO were able to resolve their outstanding differences with the Company. Arizona-American also agreed to file a revised application, containing all of the agreed upon adjustments, that ACC Staff and RUCO would stipulate to. On Wednesday, February 14, 2007, Arizona-American filed the aforementioned revised application.

AUDIT RECOMMENDATIONS:

The Company's revised ACRM request should be adopted as filed.